

**LEGISLATIVE SERVICES AGENCY
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FISCAL IMPACT STATEMENT

LS 7473

BILL NUMBER: SB 340

NOTE PREPARED: Jan 7, 2007

BILL AMENDED:

SUBJECT: Income Tax Exemption for Patent Income.

FIRST AUTHOR: Sen. Ford

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill provides an exemption from Adjusted Gross Income taxation for 50% of income that is derived from a qualified patent issued to a taxpayer domiciled in Indiana. The bill requires that a qualified patent must have resulted from a development process conducted in Indiana. It provides that a taxpayer may not claim more than \$1,000,000 in exemptions in a taxable year. It also provides that a taxpayer may not claim an exemption for income derived from a particular qualified patent for more than ten years.

Effective Date: January 1, 2008.

Explanation of State Expenditures: The Department of State Revenue (DOR) will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the new exemption for patent-derived income. The DOR's current level of resources should be sufficient to implement the new exemption.

Explanation of State Revenues: *Summary:* The bill would reduce state Adjusted Gross Income (AGI) Tax of individual and corporate taxpayers that derive income from certain patents issued after December 31, 2007. The potential revenue loss to the state from this exemption is indeterminable and could begin in FY 2009. The maximum exemption a taxpayer may claim in a taxable year is \$1 M. The maximum exemption amount translates into a \$34,000 reduction in tax liability for an individual taxpayer, and a \$85,000 reduction in tax liability for a corporate taxpayer. Thus, if 10 taxpayers qualify for the maximum exemption amount each year, the annual revenue loss could range from \$340,000 (if all the taxpayers are individuals) to \$850,000 (if all the taxpayers are corporations).

Background Information: The bill establishes an exemption from the AGI Tax for certain income derived

in the taxable year from “qualified patents” issued to “qualified taxpayers” after December 31, 2007. The exemption applies to 50% of the income derived from the patent during the taxable year, with the exemption applying to the following:

- (1) Income derived from making, using, or selling an invention protected by the qualified patent.
- (2) Royalties received from an assignment or license of the qualified patent.
- (3) Damage awards or settlement proceeds recovered for infringement of the qualified patent.

The aggregate amount of patent-related income a taxpayer may exempt in a taxable year is \$1 M. A taxpayer may claim the exemption with respect to a particular patent for up to 10 years. A “qualified patent” is a utility patent or plant patent issued for an invention resulting from a development process conducted in Indiana. Income derived from design patents is not eligible for the exemption. A “qualified taxpayer” is a taxpayer domiciled in Indiana, but does not include an institution of higher learning or a holding company.

Since 1995, an average of about 1,500 patents of all types (utility, plant, design, and other patents) have been granted annually to persons or entities in Indiana. However, annual patent totals for Indiana persons or entities have declined in recent years from a high of 1,745 in 2002 to 1,246 in 2005. The annual patent total is attributable primarily to utility patents, with utility patents granted averaging about 1,300 per year since 1995. The annual total for utility patents granted to Indiana persons or entities also has declined from a high of 1,439 in 1999 to 1,108 in 2005. Data is unavailable as to annual total plant patents granted to Indiana persons or entities, however, it appears it does not exceed 100-200 per year based on the above-described averages. In addition, data is unavailable describing the typical income generated by patents granted to persons or entities in Indiana.

Since the exemption is effective beginning in tax year 2008, the fiscal impact would begin in FY 2009. Revenue from the corporate AGI Tax is deposited in the state General Fund. The revenue from the AGI Tax on individuals is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%).

Definitions:

- (1) A *design patent* may be granted to anyone who invents a new, original, and ornamental design for an article of manufacture.
- (2) A *plant patent* may be granted to anyone who invents or discovers and asexually reproduces any distinct and new variety of plant.
- (3) A *utility patent* may be granted to anyone who invents or discovers any new, useful, and nonobvious process, machine, article of manufacture, or composition of matter, or any new and useful improvement thereof.

Explanation of Local Expenditures:

Explanation of Local Revenues: Because the exemption for individuals receiving patent-derived income would decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with a local option income tax.

Information Sources: U.S. Patent and Trademark Office, Electronic Information Products Division,
<http://www.uspto.gov/web/offices/cio/cis/prodsvc.htm>.

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